BY EMAIL

Niall O'Sullivan,
Department of Finance,
Government Buildings,
Upper Merrion Street,
Dublin 2.

21 April 2015

Dear Niall,

Re: Consultation on European Commission Green Paper on Capital Markets Union

We welcome the publication by the Department of Finance of a consultation on the European Commission's Green Paper on Capital Markets Union (CMU) in order to define Ireland's priorities in respect of CMU. We also commend the Department of Finance for taking the initiative to host a CMU workshop on 31 March 2015 to discuss and consider the challenges and opportunities from an Irish perspective.

The Commission Green Paper sets an ambitious agenda focussed on promoting the development of cross-border finance in order to boost jobs and growth in the European economy. We are strongly supportive of CMU. Our hope is that the focus will remain firmly on the growth and jobs agenda, as we must avoid creating an unintended compliance burden in the drive to bring about greater harmonisation. Striking the right balance is critical, as acknowledged by Commissioner Hill. An alignment of approach within the Commission and between the various European Supervisory Authorities and the ESRB is also fundamental to ensuring that the objectives of CMU are met and the project is not undermined.

Put simply, capital markets require an investment source and an investment destination. The Irish funds industry acts a key supporting link in that chain in its role as a cross-border fund domicile and fund servicing centre. Ireland can play its part in CMU by developing and enhancing fund product solutions as outlined in this response. Positioning Ireland as an enabler and facilitator of CMU is the best way to also support economic growth here in Ireland via employment expansion.

We would particularly highlight the development of "best-in-class" limited partnership structures to facilitate private equity, venture capital and long term investment products. IFIA will submit a strategic paper to the Department in relation to the development of Ireland as a location for the domiciling, servicing and management of private equity funds.

As requested, we have outlined in this document a list of those actions that should be taken at the domestic and at the European level to facilitate CMU. Through supporting the development of a fully functioning CMU, Ireland's funds industry can be significantly enhanced and evolve to develop new products and services. This in turn will lead to more jobs and economic activity in an industry that now employs 13,000 people across Ireland.

The priorities and actions we have set out in the response with regard to CMU are also very much interlinked and aligned with the objectives of the Government's IFS 2020 strategy for Ireland's international financial services sector and the growth and competitiveness agenda of the funds industry itself. Some of these actions, such as fit for purpose private equity structures, require immediate attention at the domestic level and we have sought to prioritise these in the document.

Ireland has developed a strong reputation as a regulated fund domicile and expert servicing centre for investment funds. Since the inception of the IFSC there have been many instances where Ireland has capitalised on EU developments and emerging trends in the market. CMU should be no different and we need to ensure that the local supervisory approach and regulatory response times on strategic issues continue to act as an enabler rather than a barrier to growing the industry in Ireland.

We look forward to engaging with you on Ireland's CMU plan and indeed on working with you over the coming years to build a successful Capital Markets Union across Europe.

Yours sincerely,

Patrick J Lardner

Patrick Lardner
Chief Executive

Annex I: IFIA responses to Dept. of Finance Consultation on European Commission Green Paper on Capital Markets Union

IRISH FUNDS INDUSTRY ASSOCIATION

1. Which areas of a CMU action plan would you like to see prioritised? Which areas require an EU regulatory response and which areas are best left either to domestic regulation or to the market?

IFIA's priorities for CMU focus on promoting the growth of investment fund products that are firmly aligned with CMU's objectives of strengthening investment in the EU's economy and providing an alternative to bank finance. The funding gap in Europe over the next five years is estimated to be in the region of $2-4 trillion.[1] The funding situation in Europe contrasts with the US where the bulk of financial intermediation takes place via the capital markets and where private equity funding and loan funding is well developed. Investment funds are an effective and regulated mechanism to channel investor capital to a range of investment opportunities. The Commission's Capital Markets Union Green Paper identifies the growth of private equity, venture capital and long term investment in Europe as a major strategic objective. These policy initiatives should be viewed as a significant opportunity for Ireland. As a major investment fund domicile and fund servicing centre, Ireland can play a key role in the development and promotion of investment fund solutions to address the objectives of CMU. IFIA has identified the following priorities for investment fund products:

- The development of a "best-in-class" Irish framework for private equity and venture capital
- A revised Loan Originating QIAIF structure which is aligned with the objectives of CMU and fits within a harmonised EU framework for loan origination
- A review of the Central Bank's "registered AIFM" regime applicable to QIAIFs to make it more proportionate for smaller and start-up managers
- The promotion of European Long Term Investment Funds (ELTIFs)
- The preservation of a vibrant money market fund sector
- Enhancements to the Irish REIT structure to internationalise its offering

A mix of actions at the European and the domestic level will be required in relation to these product initiatives as set out in the following pages. In addition to these product priorities, we wish to comment on the following areas as important considerations in developing a workable Capital Markets Union:

- EU level harmonisation and the avoidance of gold-plating at both the EU and domestic levels
- Ensuring policy initiatives within the European Commission and across the various European Supervisory Authorities and the ESRB are aligned
- Development of cross-border funds and reduction of costs
- Open architecture and a global framework
- Reporting harmonisation and the need for efficiencies

[1] Sources: Europe in transition, Bridging the funding gap, White Paper, PCS, March 2013 http://pcsmarket.org/wp-content/uploads/2013/03/Europe-in-Transition-Bridging-the-Funding-Gap1.pdf; Filling the bank-shaped hole, The Economist, 15 December 2012, http://www.economist.com/news/briefing/21568365-europes-banks-are-shrinking-what-will-take-their-place-filling-bank-shaped-hole

Summary of actions at domestic level

- Develop "best-in-class" limited partnership structures
- Industry to deliver a strategic paper to the Dept. of Finance on private equity funds
- Support industry initiatives to develop the right environment and expertise in the area of private equity and long-term investment, e.g. training programmes
- Review the Central Bank's registered AIFM regime to make it more proportionate for smaller-scale AIFMs that are important under the CMU 'ecosystem'
- The Department of Finance should designate, without delay, the Central Bank of Ireland as the Competent Authority under the EuVECA Regulation
- Review the appropriateness of certain of the Central Bank of Ireland's loan origination requirements in order to facilitate a product that will bring capital flows to SMEs in line with the objectives of CMU
- Ensure that local authorisation and supervisory processes and procedures conform with the ELTIF Regulation and do not seek to goldplate or distort the EU level requirements which have direct effect
- Facilitate the acquisition by Irish REITs of non-Irish real estate by creating an exemption from dividend withholding tax in the case of REITs paying dividends derived from foreign property to non-Irish resident investors
- Consider enabling Irish regulated funds to issue debt (rather than equity) warrants as this could provide a source of funding for corporate entities
- Remove tax barriers to debt financing for Irish investment funds that arise due to the scope of the Irish tax rules on interest withholding tax
- Conduct a review of the Irish investment funds regulatory framework to consider whether there is any disproportionate regulatory gold-plating that is contrary to the goals of CMU
- Conduct a review of Irish investment fund regulatory reporting requirements with a view to creating synergies, eliminating duplication, enhancing efficiencies and making data more available to industry in preparation for CMU
- Engage with the Central Bank in relation to authorisation review processes and how challenges and issues encountered might be addressed so as to increase efficiencies

Summary of actions at EU level

- Review all existing and relevant policy and regulatory initiatives within the European Commission and across the various European Supervisory Authorities and the ESRB to ensure they are consistent with the objectives of CMU
- Regulatory initiatives envisaged under CMU should undergo a thorough economic impact assessment and a thorough check for consistency with each other
- Remove geographic restrictions in the EuVECA on the location of the manager/investments
- Remove the AuM thresholds on managers who can qualify to set up an EuVECA
- Support the development of a harmonised EU regulatory framework for loan origination in order to ensure consistent regulatory standards and a level playing field across the EU
- Address barriers to lending by non-bank entities across EU Member States

- Consideration should be given to the level at which investment by UCITS and other retail products in ELTIFs should be permissible with regard to the overall liquidity profile of the UCITS/investment product
- Tackle tax, accounting and regulatory barriers that would prohibit investment by pension funds and insurance companies in ELTIFs and other CMU products
- Permit ELTIFs to invest in other high quality loans not originated by the ELTIF itself
- ELTIFs should be exempted from the obligation to issue a prospectus under the Prospectus Directive to avoid three separate layers of investor disclosure
- Seek to ensure that the draft Money Market Fund Regulation takes the objectives of CMU into account. This involves preserving the operational and utilitarian characteristics of CNAV MMFs for investors and also ensure that MMFs can continue to invest in ABCP which funds the real economy
- Clarify that if a REIT or a closed-ended fund has complied with the terms of the Prospectus Directive in respect of the offering of securities it should not also be subject to separate marketing or public offer rules under the AIFMD or under local national legislation relating to offers to retail investors
- Support the development of a single rulebook which is enforced effectively and consistently but which is proportionate, appropriate and avoids gold-plating via harmonisation of EU rules
- Encourage a review and cost-benefit analysis of certain requirements associated with the establishment of investment funds and management companies under the UCITS and AIFM Directives
- Resist the application of a "limitation on benefits" (LOB) rule to investment funds under BEPS as this is a significant threat to cross-border funds – an LOB rule favours domestic funds comprising of local investors which is contrary to the objectives of CMU
- Ensure the proposed "principle purpose test" (PPT) rule under BEPS does not create any additional impediments on investment funds ability to obtain treaty reliefs, given such funds are very unlikely to ever be established or used for treaty abuse purposes
- The introduction of an FTT which taxes instruments and intermediaries (e.g. investment funds) critical to CMU should be resisted as it imposes additional costs both on investors and SMEs, creating a significant barrier to the success of CMU
- Encourage a proportionate assessment process for equivalence of EU rules in relation to non-EU jurisdictions and promote international convergence of regulatory standards through bodies such as IOSCO rather than a standalone EU approach
- Promote a comprehensive review and analysis of all data and reporting requirements at both national and European level with a view to creating synergies, eliminating duplication and enhancing efficiencies in line with CMU's objectives on reporting

A. Investment fund product priorities

(i) Private equity and venture capital

Private equity is one of the three major asset strategy groupings in alternative investments, alongside hedge funds and real estate. The purpose of private equity is to provide investment to enterprises not quoted on a stock market. Private equity can be used to develop new products and technologies and to invest in start-ups (also called venture capital), to expand working capital, to make acquisitions, or to strengthen a company's balance sheet. Since the financial crisis, the role private equity can play as an alternative to bank finance has come into focus. With $3.5 trillion in AuM private equity is sizeable and growing sector internationally.[2]

<u>Development of the legislative framework for private equity</u>

Ireland can and should do more to attract the domiciling, servicing and management of private equity funds to this jurisdiction. However, the industry is inhibited by the existing legal and regulatory framework, which is not adapted for private equity. The conventional legal structure used for private equity around the world is the limited partnership (LP), where the manager is known as the "General Partner" and forms a partnership with the investors who are known as "Limited Partners". A fund domicile cannot succeed in private equity unless it has a suitable framework for limited partnerships as neither investors, managers nor their advisors focus on any other type of legal vehicle in the private equity sphere.

Revisions to the Investment Limited Partnership Act 1994 previously agreed with the Department of Finance should now be taken forward with urgency and should be supplemented by other legal changes and initiatives to develop Ireland as a centre of excellence for private equity funds.

<u>Strategy for private equity</u>

The IFIA is developing a bespoke strategy for private equity which we will submit to the Department of Finance. Our goal is to provide for best-in-class private equity structures supported by fund servicing expertise in Ireland. This is in keeping not only with the objectives of CMU but also with "IFS 2020", the strategy for Ireland's international financial services sector to drive growth through new product offerings and services.

<u>EuVECA</u>

Industry welcomed the launch of the European Venture Capital Fund (EuVECA) with the aim of boosting investment in SMEs by promoting the development of a cross-border venture capital industry. However, there are currently only 25 EuVECAs established in the EU, none of

[2] Source: 'The 2014 Prequin Global Private Equity Report', Prequin, 2014

which have been established in Ireland.[3] A review of the EuVECA structure is therefore required in order to encourage the take-up of this fund product. We have identified a number of enhancements at the EU level which could facilitate greater investment through EuVECAs. The European Social Entrepreneurship Fund (EuSEF) faces the same challenges and enhancements to the EuVECA should also be considered in respect of the EuSEF.

Removal of geographic restrictions on the location of the manager/investments

The global nature of capital markets and the need for CMU to fit within a global framework is recognised in the Green Paper. A key objective of CMU is also to attract global capital into Europe. Europe's private equity and venture capital industry is much smaller scale in comparison with the US. Analysis indicates that there are 1,765 private equity firms in Europe managing assets with over $741 million. This compares with 3,972 firms in the US managing assets of $2.2 trillion, while there are 7,981 PE firms globally managing assets in excess of $3.5 trillion.[4] The EU should not block itself off from this external expertise and investment by restricting EuVECAs only to mangers established in the EU and by restricting investments to those located in the EU or third countries with cooperation arrangements with the EU. It is right that the EuVECA should be a European regulated and domiciled fund but non-EU managers with the necessary expertise and available capital should be able to establish EuVECAs and invest internationally (not just in the EU) according to their sector specific expertise.

Removal of the AuM thresholds

The EuVECA is restricted to Alternative Investment Fund Managers (AIFMs) that manage less than €500 million, so called "registered AIFMs". This restriction was intended to enable typically smaller scale venture capital managers to avail of an EU marketing passport without having to comply in full with the significant requirements of the Alternative Investment Fund Managers Directive (AIFMD). However, this restriction significantly limits the scope of the type of manger that can use the structure and has hindered the growth of the EuVECA. The focus should be on calibrating the EuVECA correctly so that it can serve the purpose of promoting investment in non-listed companies rather than restricting the type of managers that can avail of the structure. By promoting the EuVECA brand as one that can used by AIFMs, no matter what their level of AUM, we would hope that that its brand awareness would increase in PE circles so that it could, in time, become almost as recognisable as the UCITS brand.

The EuVECA is restricted to Alternative Investment Fund Managers (AIFMs) that manage less than €500 million, so called "registered AIFMs". This restriction was intended to enable typically smaller scale venture capital managers to avail of an EU marketing passport without having to comply in full with the significant requirements of the AIFMD. However, this restriction significantly limits the scope of the type of manger that can use the structure and has hindered the growth of the EuVECA. The focus should be on calibrating the EuVECA

3 Source: ESMA register, April 2015 http://www.esma.europa.eu/page/Venture-Capital-and-Social-Entrepreneurship-Funds

4 Source: Analysis of Prequin data, November 2014

correctly so that it can serve the purpose of promoting investment in non-listed companies rather than restricting the type of managers that can avail of the structure.

Designation of the Central Bank as Competent Authority

The Central Bank is not currently in a position to apply the EuVECA Regulation because it has yet to be designated as the Competent Authority by the Department of Finance. We ask the Dept. of Finance to expedite this process so that EuVECAs can be established in Ireland. Until the Central Bank is designated as Competent Authority, it is not possible to establish an EuVECA in Ireland.

<u>Central Bank's registered AIFM regime</u>

The Irish regulatory regime currently provides that Qualifying Investor Alternative Investment Funds (QIAIFs) with a registered AIFM (as opposed to an authorised AIFM) are provided with a two-year start-up period (assuming they come within the applicable thresholds) during which the AIFM is not required to be authorised. However, after the two year start-up period, the QIAIF is required to appoint an authorised AIFM even if the QIAIF's AuM remains below the authorisation thresholds contained within AIFMD. We would query how this is proportionate or necessary in supporting CMU? The reason why AIFMD contains the thresholds for approval is because it considers that entities which operate below them do not pose a risk to the financial system and are appropriately regulated in a manner that avoids imposing a disproportionate compliance burden. However, the Irish regime imposes very significant cost and resource burdens on these AIFMs which are not proportionate and do not facilitate their growth in a sustainable manner. This challenge is particularly acute in the private equity space where fund sizes frequently fall below the €500 million mark but under Irish requirements, the manger must upgrade to a far more onerous regime. The current registered AIFM regime will have a stifling effect on CMU type activity and needs to be reviewed to make the regime more proportionate.

(ii) Loan origination funds

Loan origination by investment funds has grown in recent years in response to a funding gap created by restrictions on access to bank credit in the aftermath of the financial crisis. As with private equity, loan origination funds can play a valuable role in the EU economy by reducing over-reliance on bank credit and facilitating access to credit for viable enterprises. The promotion of loan origination is therefore firmly aligned with the objectives of CMU. It is estimated that the European private debt investment market, which includes direct lending funds, currently has assets under management of $33 billion.[5] With bank financing consistently at low levels this market has significant growth potential in future years but needs to be developed in a structured manner across the EU.

[5] Source: "Growth of Private Debt Funds in Europe Is Positive for Asset Managers", Moody's, 31 July 2014

Enhancements to the Central Bank's Loan Originating Qualifying Investor AIF (L-QIAIFs)

In recognition of the "public good" that could be served by allowing investment funds to originate loans, the Central Bank of Ireland published in September 2014 a framework for loan origination, following two consultations and significant engagement from industry. The Central Bank will permit QIAIFs to lend subject to a range of conditions covering credit assessment, diversification, liquidity limitations, investor due diligence, leverage, disclosure, stress testing and reporting.

Industry acknowledges the need for sound risk management and an appropriate level of regulation of loan origination funds. However, the L-QIAIF framework imposes restrictions to the extent that it is currently not proving viable for managers to establish and manage L-QIAIFs, which are consequently not facilitating capital flows to businesses as envisaged under CMU. The L-QIAIF framework needs to be reviewed and enhanced to make it "fit for purpose". We would draw attention in particular to the current restriction prohibiting L-QIAIFs from investing in listed securities. It is necessary for loan origination funds to allocate a portion of their portfolio to listed securities to meet operational and liquidity requirements and this also enables greater diversification and risk management. It is not clear what the prudential issues are with a loan originating fund allocating a portion of its portfolio to other assets classes. Further areas of concern include the imposition of a 200% leverage limit and the onerous stress testing requirements. Industry is engaging with the Central Bank on potential clarifications that could be made to the L-QIAIF framework. However, unless there is appetite and scope for some changes, Ireland will not be facilitating a broadly working CMU and will remain at a competitive disadvantage. As we see it, there is an opportunity here for Ireland to take the initiative, as it has done in the past in relation to AIF developments.

EU harmonisation and a level playing field

During the Central Bank's exploration of loan origination, it sought the opinion of the ESRB and endorsement to proceed with a loan originating framework.[6] While Ireland has a detailed and transparent set of requirements in relation to loan origination, this is not the case in other Member States, which means that regulatory arbitrage is currently taking place. In a report on "Trends, Risk and Vulnerabilities", ESMA highlighted loan origination as a focus area.[7] The report highlights the recent and rapid growth in both loan participation and loan origination funds and noted that "this fledgling activity should develop within a harmonised EU framework that has appropriate risk mitigants in place". IFIA welcomes the prospect of an EU harmonisation initiative to ensure an appropriate level of regulation of loan origination across the EU in order to effectively mitigate risk and also to ensure a level playing field between Member States. However, we would also caution against the systemic risk oversight or supervisory authorities imposing constraints that would stifle this growing activity, as this would go against the policy objectives of CMU. It is important to strike an appropriate balance when regulating loan origination, as has been borne out in the Irish experience.

[6] http://www.esrb.europa.eu/news/pr/2014/html/pr140331.en.html
[7] Trends, Risks, Vulnerabilities, No. 1 2015, ESMA, 11 March 2014

Addressing barriers to lending

In addition to the development of an appropriate regulatory framework for loan origination, local barriers to deploying these funds for lending need to be removed. Otherwise, we will be left with a situation where capital can be raised cross border, but in practice, not deployed cross-border. Some barriers that will need to be addressed at a European level to provide a level playing field between bank and non-bank (such as loan origination funds) lenders include:

- Removal of the legislative preference given to banks in bankruptcy proceedings - equal treatment of bank loans and bonds in bankruptcies
- Standardisation of procedures for taking security, enforcement and for creating loans/bonds, in particular equivalent standards for European company registers for registering and enforcing pledges and similar charges
- Remove barriers to lending (as distinct from deposit taking) such as the need for banking licenses etc. by allowing other regulated institutional investors or vehicles to lend
- Additional initiatives to align tax incentives at national level such as: a) the removal of withholding and of transaction taxes on lending/interest, at least within the EU and b) the legislative preference given to banks, for example in taking security (stamp duties etc.) and transaction taxes.

We would suggest that a key focus of the CMU is to look at how to surmount these barriers. Some of our members have suggested the creation of an 'asset passport' that would give qualified funds (certain AIFs or ELTIFs) the right to deploy capital cross-border on an equal footing with banks. This would, in effect, address some of these barriers in a product-specific way, rather than going down the long and politically-challenging path of harmonising all of the relevant legal frameworks across all of Europe.

(iii) European Long Term Investment Funds (ELTIFs)

Consistent with the overall objectives of the CMU, the Commission states that the recently finalised European Long-Term Investment Funds' (ELTIFs) regulatory framework will enable investors to invest in companies and infrastructure projects on a longer term basis. The Green Paper notes that ELTIFs should have particular appeal to investors such as insurance companies or pension funds which need steady income streams or long term capital growth and the Commission in its CMU Green Paper is soliciting views on what further role it and Member States could play in supporting the take up of ELTIFs, including the possible extension to ELTIFs of advantages currently available for national regimes.

Limited partnership legislation

There is a tangible opportunity for Ireland to become the domicile of choice for this product type as it emerges and develops. However, in order to capitalise on this significant opportunity, it is imperative that the necessary suite of legal structures are available and are fit for purpose. With this in mind it is important that work begins now to upgrade the current Investment Limited Partnership legislation so that it can be utilised by managers wishing to establish ELTIFs in Ireland in the near future. The speed with which legislation is formulated and delivered needs to accelerate considerably in order to capitalise on market opportunities afforded by CMU.

Authorisation and supervision locally

The ELTIF is to be adopted as an EU Regulation to avoid any gold-plating which would cause distortions of competition and undermine investor confidence in the product. Through the authorisation and supervisory processes and procedures it is essential and required directly by EU legislation that Ireland conforms with the ELTIF legislation without imposing any additional conditions. We would ask that this approach is respected. In circumstances where there are concerns regarding the framework, this should be referred to the EU level for further consideration and agreement rather than being addressed at a national level. We refer in particular to loan origination by investment funds, which is a permitted activity within the ELTIF but which can only be undertaken in Ireland currently subject to a very stringent and detailed framework not reflective of the ELTIF regime. Requiring loan origination undertaken outside the ELTIF product to be subject to significantly more onerous requirements than those within the ELTIF framework would create an uneven playing field, as well as hinder loan origination through Irish domiciled products generally.

Investment by retail products

ELTIFs will be open to retail investors and it is important that they will be complementary to UCITS as the predominant pan European retail fund product. With assets of almost €8 trillion, UCITS can provide significant investment potential for ELTIFs. There should also be scope for investment in ELTIFs by other retail investment products. Consideration should be given to the level at which investment by UCITS and other retail investment products in ELTIFs should be permissible with regard to the overall liquidity profile of these investment products.

Tackle tax, accounting and regulatory barriers

It is important to ensure that an investment in ELTIFs would not be subject to unfavourable accounting or capital treatment for other target investors such as smaller pension fund and insurance investors. Regulatory constraints under Solvency II and EIOPA's assessments which would prohibit investment by pension funds and insurance companies should be addressed. Since ELTIFs can originate their own loans, there is no reason why ELTIFs should be permitted from investing in other high quality loans and flexibility needs to be provided to do this.

Exemption from the Prospectus Directive

ELTIFs should be exempted from the obligation to issue a prospectus under the Prospectus Directive as this would constitute an additional layer of disclosures without adding value to the existing and extensive disclosure requirements under the AIFMD as well as under the "Key Information Document" to be provided as part of the Packaged Retail and Insurance-based

Investment Products" initiative (PRIIPS). It should be further assessed what is the right level of disclosures in the case of listed ELTIFs.

Promoting suitable skills and the environment in Ireland

Aligned with IFS2020, analysis should be undertaken to ensure that Ireland has the necessary skillsets and environment to support ELTIFs that there is targeted promotional activity surrounding this segment of the funds industry. Industry intends to work with governmental stakeholders on ensuring that Ireland is ready for ELTIF and will make recommendations as appropriate in that regard.

(iv) The vital role of Money Market Funds in CMU

CMU is not only an important forward-looking project, but also presents an opportunity to consider legislative proposals currently on the table. We note, in particular, that some of the potential impacts of the EU Money Market Fund Regulation (MMFR) will be contrary to the objective of diversifying the funding base in Europe and reducing overreliance on the banking system.

MMFs as an effective market-based solution for European companies

The CMU is more than just an exercise in promoting new types of financial intermediation – it should enable a pragmatic look at what roles banks will be able to play moving forward (given the considerable reforms to the regulatory framework for banks in Europe and globally), and how capital markets can complement their role, and where market-based solutions must fill in funding gaps. Moving forward, banks will find corporate cash deposits more expensive to take from a capital perspective – likely either passing those costs on to companies, or scaling back their service offering altogether. MMFs are already an important tool for European companies to manage their cash, and provide an alternative to a cash account at a bank. This option will be even more important moving forward.

We believe European policymakers should seek to find a workable outcome for companies who will need reliable cash management tools. Part of this is preserving the specific characteristics that make MMFs most useful to their users – operational ease, intra-day liquidity, and workable accounting and tax treatment. This means preserving a constant net asset value (CNAV) money market fund product under the MMF Regulation in order to avoid decimating the MMF industry. With €339 billion in domiciled MMF assets, Ireland is Europe's leading MMF domicile and over 90% of these assets are CNAV. The elimination of a viable CNAV option for MMFs will be acutely felt by the Irish industry but will also have a very damaging impact on the success of CMU due to the removal of CNAV funding for European businesses.

MMFs as an important investment channel for SME finance

While there has been considerable political focus on reviving term securitisation markets in Europe, there has been comparatively little focus on the role that Asset-Backed Commercial Paper (ABCP) plays in funding European companies. ABCP is considered short-term securitisation by some of the policymaking bodies. However, a more accurate comparison for a 'fully-supported' ABCP programme (as almost all in Europe are) would be a short-term covered bond. ABCP is a key funding tool for many SMEs – the underlying assets in the pool generally comprise of commercial and consumer receivables, equipment leases and loans – but the MMFR risks cutting off a critical investor base for ABCP. If the final regulation unduly restricts MMFs ability to invest in ABCP, a key funding source to European companies could be greatly impaired. The Commission proposal contains unnecessary restrictions on the types of assets that can be put into collateral pools (only corporate debt – where nearly all European ABCP programmes contain both corporate and consumer debt), on the maturity of the underlying assets (restricted to 397 days, where many of the programmes contain debt with a maturity up to 5 years), and also a 10% cap on the total of a portfolio that can be invested in ABCP (as opposed to be treated as exposure to a particular counterparty, as any other corporate paper would be).

(v) REITs

The Irish REIT structure introduced under Finance Act 2013 has achieved significant success in in attracting capital to the Irish property market. In line with the objectives of CMU to promote cross-border investment, we propose that tax barriers to non-Irish resident investors holding non-Irish property should be removed and also that clarifications should be made in relation to the treatment of REITs under the Prospectus Directive.

Tax changes in relation to holding international property

Certain tax changes are required if the Irish REIT is to become an attractive investment vehicle for holding international property for an international investor base. There is no prohibition on the holding of foreign property in an Irish REIT, but it is not currently an attractive investment proposition for an international investor given the applicable tax regime.

Where a non-Irish resident investor invests in non-Irish property they will incur whatever local taxes apply in the jurisdiction where the property is located and also whatever taxes apply in their country of residence. If a non-resident investor invests through an Irish REIT in non-Irish property these investors suffer an additional layer of taxation – the 20% DWT which applies to distributions made from the REIT. While this can be reduced in accordance with the terms of a relevant double taxation agreement there is still likely to be an additional layer of taxation which renders investment by non-resident investors in an Irish REIT holding foreign property unattractive.

There are a number of reasons why from a policy perspective it may be beneficial to facilitate the acquisition by Irish REITs of non-Irish real estate:

- It would allow existing Irish REITs to expand in size beyond what may be possible if REITs can only look to the Irish market to invest.
- It would enable the creation of new REITs by greatly increasing the scope of assets which can be efficiently acquired.
- It could create the potential for Ireland to become a domicile of choice in the international REIT sector potentially replicating the success that Irish domiciled funds enjoy internationally.
- This consequent increase in activity should create additional employment, both directly and in the case of service providers and professional advisors.

It should be possible to encourage the use of an Irish REIT as a vehicle for investment in foreign property by non-resident investors by creating an exemption from dividend withholding tax in the case of REITs paying dividends derived from foreign property to such investors. This change would broaden the appeal of the Irish REIT and help to expand its investor and investment base. The change would not detract from investment in Irish property, rather it would serve to attract new investment that otherwise would have gone elsewhere. The proposed solution protects revenue that would be due to the Irish Exchequer while at the same time expanding the investment scope of the REIT structure under CMU.

Prospectus Directive and REITs

In relation to the treatment of REITs (as well as closed-ended funds), there is considerable overlap between the Prospectus Directive and AIFMD which is unhelpful and adds to the compliance burden. We have outlined the issue in greater detail in our response to Question 3. In summary, the key change we are seeking is that REITs and closed-ended funds that have complied with the terms of the Prospectus Directive in respect of the offering of securities should not also be subject to separate marketing or public offer rules under the AIFMD or under local national legislation relating to offers to retail investors, as that would run contrary to the harmonisation of public offer rules that the Prospectus Directive sets out to achieve.

B. Important considerations in building CMU

(i) EU level harmonisation and the avoidance of gold-plating

Since the financial crisis of 2007/2008, there has been a substantial level of new financial services legislation at EU level. We therefore welcome the fact that the current EU Commission intends to focus its resources on (a) reviewing the effectiveness of recent EU financial legislation and (b) producing fewer new legislative proposals (with the new legislative proposals focusing on a number of key priorities such as enhancing the effectiveness of a single capital market).

<u>EU level</u>

We note that the CMU proposals are intended to be introduced within a "single rulebook". We agree with the concept of a single rulebook and consider it beneficial to have a harmonised approach to the implementation of financial legislation when it is enforced effectively and consistently. However, we would caution against turning CMU into an exercise which leads to gold-plating arising as a result of the drive to ensure harmonisation. Striking the right balance in terms of any regulation arising out of CMU will be critical. Any review of financial services legislation should include an evaluation of the appropriateness and effectiveness of the legislation, including whether it is achieving its goal in a proportionate manner. Regulatory initiatives envisaged under CMU should undergo a thorough economic impact assessment and a thorough check for consistency with each other.

<u>Domestic level</u>

From an Irish perspective, the opportunity should also be taken to consider these matters domestically as well as certain of the operational aspects of the regulatory framework both from the consumer and supply side. Such review should include the use of regulatory resources and consider whether there is any disproportionate regulatory gold-plating. We have set out below a small number of examples of matters which in our view would be worthy of review in this respect:

Are domestic regulatory requirements proportionate or gold plating?

A significant level of work was carried out by many parties including the Central Bank, various government departments and industry in order to implement the AIFMD it in Ireland in a timely and effective manner. This work included preparing the requisite legislation and putting in place the regulatory regime to facilitate its operation in Ireland. Now that this system is in place, there should be a review of how it operates in order to ensure that post implementation it achieves its goals in an appropriate and proportionate manner while facilitating the growth of the industry in Ireland. By way of example, we cite the "registered AIFM regime" as referenced above under Private equity, which requires the automatic conversion of a subthreshold AIFM operating under a de minimis regime to a fully authorised AIFM.

Issue of debt by regulated funds

Separately we also think that the regulatory restrictions upon issuing debt (rather than equity) warrants review as it could be beneficial for regulated funds to have the capacity to do so and potentially be a source of funding for certain corporate entities.

Attracting retail investors

In terms of attracting retail investors, we are of the view that the streamlining of the content of offering documents is an important issue. Having a succinct and easily comprehensible offering document is a very important element for selling to retail investors. Not just for closed-ended funds under the Prospectus Directive but generally. In this regard, despite the fact that a significant amount of work has been carried out in respect of UCITS Key Investor Information Documents (KIIDs) and also PRIIPs it would be worth reviewing the cost of preparing and updating them to ascertain whether they can be produced more efficiently in terms of both costs and resources. A consistent approach should be applied across other fund raising and investment products. Furthermore, in our view it should not be necessary to impose a limit on the length of a prospectus but rather to review if all the required regulatory disclosure is necessary.

(ii) Policy initiatives within the European Commission and across the various European Supervisory Authorities and the ESRB need to be aligned

We note the apparent divergence between the Commission's objective to increase market-based finance and a number of regulatory initiatives currently underway both within the European Commission and across the EU institutions. The Commission needs to work with other EU bodies to resolve any mismatches in approach that could risk undermining the objectives of the CMU. In this regard, we would highlight:

- The proposed Money Market Fund Regulation (see above section on MMFs)
- The proposal for a Financial Transaction Tax which would act as a deterrent to investing in capital markets
- MiFID II rules on pre- and post-trade transparency for fixed-income which could inhibit new issuance and/or reduce secondary market activity
- The recently published EBA consultation on shadow banking guidelines for entities falling outside of a regulated framework

Despite being targeted at unregulated entities, the draft EBA guidelines[8] propose to bring all types of AIFs and all money markets funds within scope of onerous prudential requirements,

[8] EBC Consultation Paper - Draft EBA Guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395 para. 2 Regulation (EU) No. 575/2013, 19 March 2015

notwithstanding the fact that such funds are subject to either the detailed requirements of the UCITS or the AIFM Directives. Money market funds, whether structured as UCITS or AIFs, will additionally be subject to the new Money Market Fund Regulation. There is a persistent approach to regulate investment funds undertaking portfolio management as if they were banks – this approach does not align with CMU and needs to be addressed.

(iii) Development of cross-border funds and reduction of costs

Ireland has been a pioneering location in the development and promotion of cross-border investment funds, commencing with the UCITS Directive and continuing with AIFMD. We welcome the goal under CMU to encourage further the establishment of cross-border funds and to reduce set-up costs associated with these funds.

<u>Review of management company requirements</u>

In that regard, we would welcome an EU review and cost-benefit analysis of the requirements associated with the establishment of investment funds and management companies under the UCITS and AIFM Directives. The level of requirements imposed in recent years on management companies have been significant and can work against a cross-border management model in which delegation is prevalent and more in favour of a domestic type industry. We would highlight various organisational and operational requirements as well as AIFMD's rules relating to delegation. These rules can detract from fund managers setting up and marketing UCITS and AIFs on a cross-border basis and should be reviewed on a cost benefit basis to ensure that they are proportionate. We have set out some further examples below of requirements that should be amended and would be happy to engage separately on this initiative.

Master-feeder arrangements under UCITS IV

UCITS IV sought to increase efficiencies in the European fund market through greater rationalisation and the generation of economies of scale. One tool to achieve this was the provision for master-feeder structures under the UCITS framework. However, the application of a "10% rule" prevents UCITS which invest more than 10% in another fund from investing in a feeder fund. This discourages managers from setting up feeder fund structures as many managers would thereby exclude a key part of their potential client base. We recommend that the 10% rule be amended to allow 'look through' to the underlying master into which the feeder UCITS/CIU invests such that the 10% rule applies to the master fund.

The requirement to appoint local facilities any paying agents

The requirement to appoint local facilities any paying agents dates back to the original UCITS Directive in 1985 and has been carried forward in previous revisions to UCITS and also under AIFMD and the ELTIF Regulation. These requirements developed at a time when cross-border bank transfers in the EEC were slow and expensive and it was difficult to obtain adequate information on a cross-border basis at a time before the internet existed. Furthermore, the rules assume a model of direct UCITS sales whereas in practice the vast majority of UCITS sales are intermediated through a local advisor or execution platform, which is designed to facilitate payments and provide access to all information a retail investor may need. The result is that currently managers put in place facilities agents and paying agency agreements around Europe which are in practice never used.

We recommend that these requirements under the UCITS Directive and ELTIF Regulation should be updated with rules which reflect the widespread use of the internet, the ease with which cross border payments can be made and the reality of contemporary distribution models.

Central Bank's authorisation process

We welcomed the review of authorisation standards by the Central Bank under CP 67 with a view to enhancing efficiencies in the authorisation process, which can in turn reduce costs. We also welcome the inclusion of operational metrics for the Central Bank under IFS 2020. Furthermore, we propose to engage with the Central Bank in relation to authorisation review processes and how challenges and issues encountered might be addressed so as to increase efficiencies.

BEPS

The OECD Action Plan on Base Erosion and Profit Shifting (BEPS), published in July 2013, identified 15 actions to address BEPS in a comprehensive manner. One of these areas for action is to "prevent the granting of treaty benefits in inappropriate circumstances" (Action 6). Action 6 proposed the introduction of two possible tests which would need to be met in order to obtain treaty benefits – the Principal Purpose Test (PPT) and the Limitation on Benefits Test (LOB).

The OECD was mandated under Action 6 to conduct further work with respect to treaty entitlement of collective investment vehicles (CIVs) and non-CIV funds. To take this forward, the OECD published on 21 November 2014 a discussion draft for public comment.

The introduction of either the PPT or LOB rule as currently drafted would represent a significant threat to cross-border funds, as both would likely favour domestic funds comprising of local investors.

A CIV is very unlikely to be established or used for treaty abuse purposes. For this reason and recognising that the purpose of Action 6 of the BEPS project is to prevent treaty abuse, it is our view that, to the greatest extent possible, the output from Action 6 should impose no additional impediments on CIVs ability to obtain treaty reliefs.

In this regard, we support the conclusions of the OECD's 2010 CIV Report, which recognises the importance of widely held funds being able to access treaty benefits. This report should continue to be the basis for determining treaty access for CIVs, particularly with regard to CMU's objective of promoting cross-border funds.

We note that the 2010 CIV Report did not deal with treaty entitlement issues relating to collective investment funds which are not widely held, regulated and diversified. This may include some classes of private equity funds and alternative funds which share many of the same characteristics as CIVs. In particular, (like CIVs) non-CIV funds are established for bona fide commercial purposes.

As such, it is equally important that the output from Action 6 imposes no additional impediments on bona fide commercial non-CIV funds ability to obtain treaty benefits. We would recommend that work similar to the 2010 CIV Report needs to be undertaken through the OECD Informal Consultative Group to identify issues across the various types of non-CIV funds and develop practical solutions for treaty entitlement.

(iv) Open architecture and a global framework

We very much welcome the recognition in the Green Paper that capital markets must be open and globally competitive and designed to take into account the wider global context and framework. CMU will simply not function effectively in our opinion unless the EU framework is interoperable with other jurisdictions, given the interrelated nature of capital markets. Several EU regulatory frameworks, such as AIFMD, EMIR and MiFID II, require cooperation arrangements and equivalence assessments with other jurisdictions. We would emphasise the need for a proportionate assessment process, which takes into account the need to recognise differing requirements which can achieve the same effect.

We would highlight ESMA's consultation on asset segregation guidelines under AIFMD as a recent example. Industry highlighted the need for a more market-specific approach to asset segregation in recognition of local legal, regulatory and operational arrangements. We welcome efforts under CMU to bring about greater insolvency harmonisation in that regard.

We also support initiatives to strengthen the global regulatory framework such as IOSCO's consultations on the custody of collective investment scheme assets and on cross-border regulation. In particular, the challenges arising from diverging global rules in the area of insolvency protection and asset segregation are encountered by Irish depositaries overseeing the investments of cross-border funds invested globally. IFIA would welcome a global initiative to ensure effective legal recognition of the segregation of a fund's client assets from the proprietary assets of the relevant fund's custodian.

(v) Reporting harmonisation and the need to focus on efficiencies

As each new EU regulation is released, an additional reporting or data requirement is imposed either directly or indirectly on asset managers and/or service providers, such as under AIFMD, UCITS IV, EMIR, the EU Money Market Fund Regulation, MiFID II, Solvency II etc. The cost of complying with such requirements is extremely high for firms and while many of the bigger asset managers and service providers have, in some cases, been able to absorb the cost due to their scale, these obligations can be particularly prohibitive for smaller players and new start-ups which does not aide innovation that CMU seeks to promote. Where costs cannot be absorbed they will ultimately reduce shareholder returns.

While we do appreciate and understand the reason for and reliance placed on data by supervisory authorities across the EU, we would advocate strongly for more of a consistent and strategic approach to these requirements. An integrated reporting strategy would improve market efficiencies, reduce costs and avoid duplication and overlap. CMU presents the opportunity to develop the integrated approach to reporting. A starting point would be a comprehensive review and analysis of all data and reporting requirements at both national and European level, what is required, by who, for what purpose and whether data received to date is fit for purpose. This analysis should also identify where synergies can be achieved and duplication avoided. Consistent with a global approach, the analysis should consider the data and reporting requirements from authorities outside the EU for example Form PF under Dodd Frank in the USA.

2. ***The Commission's indicates some key features that would underpin a "high quality securitisation market". What potential opportunities might this create for Ireland and what needs to be done within a domestic and EU context to maximise any such opportunities?***

As you are aware, there is a vibrant securitisation market in Ireland and Ireland is a jurisdiction of choice for many securitisation issuing vehicles or special purpose vehicles (SPVs). The securitisation industry is separately represented and is very different to the funds industry for a number of reasons, including a different investor base and different structures. Securitisation SPVs are incorporated as private or public limited companies rather than investment companies or unit trusts. Unlike Collective Investment Schemes, SPVs are not required to be authorised by the Central Bank of Ireland.

However, the two industries are complementary, a vibrant securitisation industry in Ireland will support the continued development of the Irish funds industry and vice versa. If EU policy is directed towards developing further the EU securitisation industry, policy in Ireland should accommodate to the greatest extent possible the maintenance of and where possible growth of Ireland's leading position in this industry, which would be of benefit to Ireland's overall offering as an international financial services centre.

3. ***To what extent is the current Prospectus regime considered to be a barrier to more SME issuances? What single change to the current Prospectus regime could have the most positive impact in terms of improving Irish SME issuances?***

The development of private placement is a way to promote the market funding of small and medium-size companies that may not otherwise have access to debt markets.

Private placement in the EU typically takes the form of corporate bonds or loans sold to institutional investors who buy them either directly or within fund structures. It facilitates loan participation and loan origination for two reasons: first, it allows an "originate-to-distribute" model whereby banks underwrite debt using their credit expertise and their close relationships with companies and distribute this debt to investors through the fund structure. Secondly, private placement helps the standardisation of loans and their documentation, thus making them a more investable and liquid product for both loan participation and loan origination funds.

We therefore think that a coordinated approach to the creation of regulated loan/loan origination funds with the introduction of an EU wide framework for private placement of corporate bond or loans is required. We have set out below further issues arising in relation to the Prospectus Directive from a funds industry perspective.

Conflict between the Prospectus Directive and AIFMD

Certain entities (such as closed ended funds and certain REITs) can be subject to both the Prospectus Directive and the AIFMD when making an offer of shares/units. There is considerable (and at times contradictory and unhelpful) overlap between the Prospectus Directive and AIFMD. Such entities fall under the Prospectus Directive insofar as their activities relate to the offering of securities throughout the EU. Offers of securities in such entities also come within scope of AIFMD if they fall within the definition of an AIF and have an authorised AIFM insofar as their activities relates to the marketing of units or shares of AIFs in the EU (the term "marketing" would cover most offers of securities).

If an entity (be it a REIT or a closed-ended fund) has complied with the terms of the Prospectus Directive in respect of the offering of securities, then it should not also be subject to separate marketing or public offer rules under the AIFMD or under local national legislation relating to offers to retail investors, as that would run contrary to the harmonisation of public offer rules that the Prospectus Directive sets out to achieve.

We do not propose that an entity (be it a closed-ended fund or REIT) that was subject to the Prospectus Directive would automatically fall outside the AIFMD altogether but rather EU law should make it clear as to which set of securities offer rules (be it the Prospectus Directive or the AIFMD and applicable national legislation) should apply to the offer of securities in those entities throughout the EU.

We understand that open-ended investment funds would remain out of scope of the Prospectus Directive post the review, as is currently the situation.

4. ***Which areas of CMU have the greatest potential to impact upon the attractiveness of Ireland as a location for inward investment?***

From the perspective of the IFIA, the parts of the CMU that have the most obvious potential for Ireland are the areas promoting investment fund products. This includes the sections relating to boosting long term investment and boosting institutional and retail investment as well as attracting international investment. We have highlighted key areas of focus for the funds industry under Question 1. All of these initiatives play directly to the strengths that Ireland has developed as a leading global fund domicile and servicing hub. In addition they dovetail perfectly with the government's IFSC 2020 strategy.

The key for Ireland is to ensure that the rules created do not become overly prescriptive as to diminish the attractiveness of European funds to non-EU asset managers & investors. As any reduction in the popularity of European funds would have a knock on effect on Ireland as a leading European fund domicile. Additionally, we must also guard against provisions being put in place that would unduly favour one EU member state of another.

Overall, asset management will play a key role in the success of the CMU. Given Ireland's position as a key centre for the serving of asset management, we should be well placed to benefit from this aspect of the CMU in terms of jobs and growth in the funds industry and the local economic spin-off activity that will arise as a bi-product of that growth.

5. ***The green paper raises the possibility of some far-reaching CMU elements (for example relating to supervisory convergence, company law, differences in tax regimes). How might such horizontal changes impact on Ireland, both in terms of our domestic market and more generally our attractiveness as a location for inward investment?***

<u>Supervisory convergence</u>

In our view, it should not be necessary to add any further requirements to those imposed under the Irish regulatory regime in respect of organisational requirements (indeed we think that these requirements could be reviewed in the context of costs and proportionality). However, we would generally welcome supervisory convergence through the single rulebook and guidance upon its interpretation (in respect of operational requirements and investment restrictions), as this will help to bring about a level playing field with less scope for regulatory arbitrage.

We would draw a distinction between consistent application of the single rulebook through supervisory convergence and peer review versus a pan-European supervisor (as has occurred under Banking Union). We do not think that a pan-European supervisor is necessary or desirable and could serve to detract from the key goal of establishing CMU by 2019.

In relation to supervisory convergence it may be worth reviewing the effectiveness of the comply or explain procedures in respect the adoption of ESMA Guidelines by EU Member State regulators to ensure consistent application of the proposed standards in all Member States.

While considerable work has been done in recent years in relation for example to cross border mergers, we agree that considerably more work could be done in areas such as insolvency.

Taxation

From a taxation perspective, it is important that Ireland continues to retain an attractive taxation environment for inward investment, while ensuring that our tax system adapts to changes enforced by global initiatives such as the OECD BEPS project. Taxation policy which is designed to attract foreign direct investment with real jobs and real substance is key in this regard.

We acknowledge that several measures introduced in Budget 2015 and Finance Act 2014 (such as the changes to the SARP regime and proposed introduction of a "best in class" Knowledge Development Box regime) demonstrate the Government's ongoing commitment to introduce tax measures which support foreign direct investment. It will be critical that any tax changes proposed as part of the CMU do not negatively impact on Ireland's attractiveness as a jurisdiction in which to do business. In this regard, we echo the Minister for Finance's recent comments that Ireland's tax strategy needs to continue to be "to play fair but play to win".[9]

However there are still certain areas of Irish tax law which can create barriers to inward investment. In particular, many Irish investment funds will often encounter issues when raising debt finance due to the scope of the Irish tax rules on interest withholding tax.[10] While there are exemptions from interest withholding tax for interest paid on quoted Eurobonds and wholesale debt, these exemptions only apply where the debt is issued by a company. A large number of Irish investment funds are not constituted as companies, but as unit trusts or investment limited partnerships. While a broad interest withholding tax exemption does exist for "specified collective investment undertakings", this exemption is no longer available to newly established funds.

As part of the implementation of the CMU proposals, we would recommend that the "specified collective investment undertaking" exemption from withholding tax be expanded from its current application to apply to all "investment undertakings". The matching exemption from Irish income tax which currently applies to non-resident recipients of interest payments from "specified collective investment undertakings"[11] could also be expanded to cover interest payments from all "investment undertakings".

These changes would allow Irish investment funds to obtain bilateral debt finance from all capital providers, irrespective of their tax residency or tax status. No erosion of tax base would be anticipated as Irish investment funds are exempt from tax. Safeguards could be included

[9] Address by Michael Noonan TD, Minister for Finance - International Taxation and Economic Growth Conference, 21/10/2014
[10] These issues are in addition to the regulatory issues currently experienced by regulated funds when issuing debt, which have been discussed elsewhere in this submission.
[11] Section 198(1)(c)(i)(II) Taxes Consolidation Act 1997

where appropriate (e.g. to ensure that debt finance is provided on arm's length terms and not from connected parties etc.).

Improving the interest withholding tax regime for Irish investment funds would enhance their ability to raise debt finance from non-traditional sources. This in turn could allow Irish investment funds to act as alternative sources of finance for all companies, especially SMEs – one of the key priorities of the CMU.

6. ***What developments are required to make European private placement markets more attractive to Irish companies vis-à-vis the US? Is there scope for companies that currently cannot realistically secure private placements to benefit?***

   No comments

7. ***Taking into account the establishment of a Central Bank owned central credit registry, how well does Ireland fare in terms of SME data coverage, fragmentation, quality, integrity, etc? What opportunities or issues may arise for Irish SMEs in the event of the creation of an EU credit database or at least formal arrangements between national database owners that would go in this direction? To what extent would such developments likely meet investors' requirements and thus encourage greater investment in SMEs?***

   No comments

8. ***What is the potential for the MiFID II created "SME Growth Market" to support more IPOs by Irish firms with a market capitalisation of up to or a little beyond €200 million? What needs to be done to realise any such potential?***

   No comments

9. ***How might equity markets generally better serve the financing needs of Irish SMEs and mid-caps?***

   No comments

10. ***How can participation levels (direct or indirect) by retail investors in the capital markets be increased? What role can EU or domestic policy play in this regard? What steps can be taken to improve transparency and comparability for retail products?***

According to an ECB statistics paper (Series No 2 / April 2013) only a small fraction of European households – between 5% and 12% – own bonds, publicly traded shares or mutual funds. The paper goes on to state that the ownership rates of mutual funds follow a broadly similar pattern to that of traded shares, with participation being very much related to income and net wealth, age of the reference person, education and work status.

Among households in the lowest quintile of the income distribution, only 2.2% own publicly traded shares, in contrast to 24.4% in the top quintile. This difference is very similar to the one observed along the wealth distribution, where around 1 out of 4 households in the top quintile own publicly traded shares, in contrast with around 1 out of 83 households in the bottom quintile. With regard to age, holdings of publicly traded shares also show a hump shape, initially increasing with age and then declining, a pattern that is in line with a life-cycle behaviour of accumulating savings over working-life, while spending savings after retirement.

The report also suggested that, age and education might jointly explain the hump-shaped holding of shares. Indeed, ownership rates differ substantially by education (only 4.2% of households with a reference person with primary or no completed education participate in stock markets, as opposed to 19.6% of households where the reference person has received tertiary education).

Looking that the market in a different way, according to European Fund and Asset Management Association, at the end of 2013, financial assets of households (retail investors) in Europe were allocated 41.6% to deposits, 37.4% to insurance and pension savings, 8.5% to investment funds, 7.3% to debt securities and 5.2% to quoted shares.

In contrast, in the US, according to the US Investment Company Institute, the greatest share of registered investment company assets is held by households, and registered investment companies managed 22% of household financial assets at year-end 2013. Approximately 43% of, U.S. households own mutual funds.

With this background in mind it is worth looking at how investing behaviours might be influenced to boost retail investor participation in the capital markets.

- It is clear that educational attainment is an important factor which influences investing behaviour. Planning for retirement has never been more important but is often something which is left until later in life. The concepts and basic principles of saving and investing should be included in the primary school curriculum.
- In the US 401(k) employer-sponsored retirement plans have become a common channel through which households own mutual funds and this has contributed to the high proportion of US households owning such funds. At its first meeting of 2015, the Cabinet discussed the introduction of a "new, universal supplementary pension savings scheme". We would wholeheartedly support this initiative and would be eager to provide any assistance which our members can offer as Government works to design and implement such as scheme. Collective investment funds such as UCITS funds have many of the features that could be used for such pension saving schemes.

- Banks and insurance companies control a very significant proportion of the distribution channels for all financial products in Europe. As a result retail investors are presented with a range of different and competing products and making an informed comparison between these differing products can be challenging. The UCITS KIID has gone some way to achieving this by enabling comparison between different UCITS funds and the introduction of a common standardised approach to retail disclosures under the PRIIPs KID initiative is desirable to enable cross product comparisons on a consistent basis.
- How investment funds are distributed and the current MIFID II proposals which ban commissions for IFAs only while bank-dominated distribution channel are not directly affected could distort the environment and impact on the distribution of investment funds to retail investors.
- Positive steps were taken in UCITS IV to help consolidate fund product with consequent cost efficiencies. Further enhancements should be considered as, for example, UCITS master feeders are reasonably onerous to implement.
- The potential impact which the proposed European Union financial transaction tax (EU FTT) could have on the distribution of investment funds should be reviewed. If the purchase and sale of units or shares in investments funds is subject to FTT this could increase the costs to investors of investing in investment funds and also adversely impact on the return which investors derive from their investment.

11. ***What is considered to be "appropriate regulation" for crowdfunding within a national or EU context? To what extent would an EU 'passporting' regime for crowd-lending and/or crowd-investing provide opportunities for Irish SMEs?***

Crowdfunding is a growing source of alternative finance and has the potential to play an important role as a complement to traditional sources of financing, particularly for start-up companies and growing businesses. Indeed, in some jurisdictions crowdfunding is in the process of realising this potential.

Crowdfunding business models generally involve a platform that acts as a meeting point through which fund seekers advertise their projects to potential fund providers. If a crowdfunding platform is used, then crowdfunding transactions involve three categories of participants, namely fund seekers (including SMEs), platform operators and fund providers (investors). Those providing funds may do so as a donation or reward. They may also provide funds through a loan or through investments such as the purchase of a debt, equity or other security. These latter types of loan and investment based crowdfunding are of particular relevance to SMEs.

Unregulated crowdfunding presents a number of risks for each category of participant, as the European Banking Authority (EBA) outlined in a recent Opinion (EBA/OP/2015/03). According to that Opinion, risks to investors include counterparty or credit risks; risks arising from lack of transparency or misleading information; legal risks, operational risks and risks arising from fraud. More specifically, in the domestic context, it is worth noting that in June 2014, the Central Bank published a Consumer Notice on Crowdfunding, alerting consumers to the fact that it is not currently a regulated activity in Ireland and to the existence of specific risks associated with crowdfunding investments.

As is clear from the EBA's Opinion, the investor protection issues posed by crowdfunding are similar to those which arise in other areas, including in particular asset managers who engage in loan origination. This underscores the need to establish a balanced regulatory framework for crowdfunding which ensures that crowdfunding investors are effectively protected and the existence of a level playing field between crowdfunding and other types of investment opportunities.

Generally, appropriate regulation of crowdfunding, whether at national or EU level, should take into account a number of considerations. Specifically some models of crowdfunding may already fall under the scope of existing legislation and the regulators should clarify the applicability of this legislation to crowdfunding. The need for such clarification is supported by both the European Securities and Markets Authority (ESMA) and the EBA. Relevant existing legislation may include, for example, the Markets in Financial Instruments Directive, the Alternative Investment Fund Managers Directive, the Prospectus Directive and the Payment Services Directive.

Once the scope of application of the existing legislation is clarified, regulators should review that legislation to ensure that it provides investors with a level of protection which is at least equivalent to that provided in investment management, while also taking into account any specific risks posed by crowdfunding. For example, the current review of the Prospectus Directive should take into account the potential impact of that Directive on crowdfunding.

In addition, the new regulatory framework should be proportionate and avoid a "one-size fits all" approach. There are a number of different crowdfunding models and within those models themselves crowdfunding participants, including in particular crowdfunding platforms, are likely to have different characteristics. Investor protection issues may differ depending on the crowdfunding model used.

Furthermore, given the fast evolving nature of the crowdfunding landscape, the new regulatory framework will need inbuilt flexibilities so that it continues to ensure adequate investor protection in the face of technological development. It will clearly be a challenge to devise a regulatory framework which is sufficiently flexible from a developmental perspective while simultaneously providing the necessary level of harmonisation to promote trust and confidence in crowdfunding and prevent regulatory arbitrage.

In the event that the EU does not intend to address crowdfunding in the short-term, Ireland should develop its own regulatory framework. Pending this, it would be useful if the Central Bank were to provide clarity as to how it considers existing legislation applies to loan and investment based crowdfunding.